

VZCZCXRO9809
RR RUEHCHI RUEHCN RUEHDT RUEHHM
DE RUEHJA #1082 1550948
ZNR UUUUU ZZH
R 030948Z JUN 08
FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 9182
RUEATRS/DEPT OF TREASURY WASHDC
INFO RUEHXS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHKO/AMEMBASSY TOKYO 2056
RUEHBJ/AMEMBASSY BEIJING 5102
RUEHBY/AMEMBASSY CANBERRA 2593
RUEHUL/AMEMBASSY SEOUL 4645
RUEAIIA/CIA WASHDC

UNCLAS JAKARTA 001082

SIPDIS
SENSITIVE

DEPT FOR EAP/MTS AND EB/IFD/OMA
TREASURY FOR IA-SETH SEARLS
COMMERCE FOR 4430/KELLY
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR CURRAN
DEPARTMENT PASS EXIM BANK
SINGAPORE FOR SBAKER
TOKYO FOR MGREWE
USDA/FAS/OA YOST, MILLER, JACKSON
USDA/FAS/OCRA CRIKER, HIGGISTON, RADLER
USDA/FAS/OGA CHAUDRY, DWYER
USTR WEISEL, EHLERS

E.O. 12598: N/A
TAGS: [EFIN](#) [EINV](#) [ECON](#) [EAGR](#) [ID](#)
SUBJECT: INFLATION SURGES ON HIGHER FOOD AND UTILITIES

REF: A) Jakarta 1007 B) Jakarta 1033

1. (SBU) Summary. Indonesia's headline inflation rate jumped to 10.4% (y-o-y) in May, the highest rate since September 2006. Rises in food, housing, utility and transportation prices drove the overall increase. Core inflation increased to 8.7% (y-o-y) in May up from 8.2% in April, suggesting that higher food and fuel prices are slowly starting to impact other products. Analysts expect further increases in inflation in June, since the full impact of the fuel price hikes is not captured in the May data. Rising prices continue to put pressure on poor households and complicate economic decision making in Indonesia. End Summary.

Inflation Soars on Food, Housing and Utilities

2. (U) Indonesia's headline inflation rate jumped 1.4% (m-o-m) bringing the y-o-y inflation rate 10.4%, the highest rate since September 2006. Increases in food, housing, utility and transportation prices drove the overall rate of inflation. The rapid increase surprised most analysts, given that Indonesian food prices often decline from April to May in line with the harvest season, according to a J.P. Morgan report. Food prices have increased 5.5% year-to-date and 18.2% from May 2007. The rapid rise in food, housing and transportation costs will exacerbate already waning consumer confidence and place significant strain to poor household budgets (ref A).

3. (U) Core inflation (which excludes volatile categories such as food and energy) increased to 8.7% (y-o-y) in May up from 8.2% in April, suggesting that higher food and fuel prices are slowly starting to impact other goods. Given that the May price data do not include the full impact of the increase in subsidized fuel prices, which occurred in late May, analysts expect inflation to accelerate further in June. Transportation costs, which rose 2.1% (m-o-m) in May, are expected rise by 15-30% in June, in response to fuel price hikes.

Tough Policy Decisions Ahead

14. (SBU) If food and oil prices remain high or climb further, Indonesia's monetary policymakers will face an increasingly difficult decision making environment. Most analysts expect the central bank to react swiftly to the new price data by raising interest rates by as much as 50 basis points later this week. During a donor's briefing in Jakarta, IMF representatives also expressed confidence in the central bank's commitment to fight inflation. Yet, some analysts assert that Indonesia delayed interest rate hikes for too long, and that the central bank will need to raise rates dramatically in the coming months to regain control over inflation. Other analysts worry that aggressive monetary tightening will significantly slow economic growth while doing little to control inflation, which has been driven by external forces.

15. (SBU) High global food and fuel prices will also continue to create difficult fiscal decisions for the government. If global oil prices remain at or near current levels, pressure on government finances and smuggling should remain at manageable levels. Higher global food and oil prices would put renewed pressure on the budget, re-ignite smuggling, and exacerbate domestic inflation (ref B). Higher inflation rates would also dilute the effectiveness of the governments cash transfer program and other pro-poor programs in advance of the 2009 election. Even at current oil prices, the government's ability to expand social and development spending is limited. Yet, the IMF estimates that every \$1 increase in the global price of fuel will raise the fuel subsidy bill by Rp 2-3 trillion. If world oil prices increase to \$150 per barrel, the fuel and electricity subsidy bill could exceed 25% of the budget.

HEFFERN